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LEGISLATIVE RESEARCH COMMISSION

REVENUE LAWS



REPORT TO THE 1987 GENERAL ASSEMBLY OF NORTH CAROLINA

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STATE OF NORTH CAROLINA
LEGISLATIVE RESEARCH COMMISSION
STATE LEGISLATIVE BUILDING
RALEIGH 27611



December 12, 1986

TO THE MEMBERS OF THE 1987 GENERAL ASSEMBLY:

The Legislative Research Commission submits to you for your consideration its final report on the revenue laws of this State. This report was prepared by the Legislative Research Commission's Revenue Laws Study Committee pursuant to Chapter 790 of the 1985 Session Laws.

Respectfully submitted,

A stylized, handwritten signature in dark ink, appearing to read "J. J. Harrington".

J. J. Harrington

A handwritten signature in dark ink, appearing to read "Liston B. Ramsey".

Liston B. Ramsey

Cochairmen
Legislative Research Commission

1985-87

LEGISLATIVE RESEARCH COMMISSION MEMBERSHIP

House Speaker Liston B. Ramsey, Cochairman	Senate President Pro Tempore J. J. Harrington, Cochairman
Representative Chris S. Barker, Jr.	Senator Henson Barnes
Representative John Church	Senator A. D. Guy
Representative Bruce Ethridge	Senator Ollie Harris
Representative Aaron Fussell	Senator Lura Tally
Representative Barney P. Woodard	Senator Robert Warren

PREFACE

The Legislative Research Commission, established by Article 6B of Chapter 120 of the General Statutes, is a general purpose study group. The Commission is cochaired by the Speaker of the House and the President Pro Tempore of the Senate and has ten additional members, five appointed from each house of the General Assembly. Among the Commission's duties is that of making or causing to be made, upon the direction of the General Assembly or either house thereof, "such studies of and investigations into governmental agencies and institutions and matters of public policy as will aid the General Assembly in performing its duties in the most efficient and effective manner" (G.S. 120-30.17(1)).

Chapter 790 of the 1985 Session Laws authorizes the Legislative Research Commission to study various topics. The Commission undertook studies of many of the topics listed in that Chapter and grouped those studies into ten broad categories. The Commission assigned each of its members the responsibility for supervising the studies in one of these categories. Committees consisting of members of the General Assembly and the public were appointed by the Commission cochairmen pursuant to G.S. 120-30.10(b) and (c) to make these studies. Cochairmen, one from each house of the General Assembly, were designated for each committee.

The study of the revenue laws is one of the studies authorized by Chapter 790 of the 1985 Session Laws. Section 1,

subdivision (1) of that Chapter authorizes the Legislative Research Commission to continue its study of the revenue laws begun in 1977. Because Chapter 790 is a compilation of many joint resolutions and bills authorizing the Legislative Research Commission to study a particular topic, Section 1 of that Chapter authorizes the Commission to consider the original bill or resolution proposing a particular study in determining the scope of the study. House Joint Resolution 17, introduced by Representative Daniel T. Lilley in the 1985 Session, is the originating legislation for the study of the revenue laws. That resolution gives the Research Commission's study of the revenue laws a very broad scope, stating that the "Commission may review the State's revenue laws to determine which laws need clarification, technical amendment, repeal, or other change to make the laws concise, intelligible, easy to administer, and equitable." Chapter 790 and House Joint Resolution 17 are attached as Appendix A.

The Legislative Research Commission grouped the study of the revenue laws in the category "Revenue" under the direction of Senator Robert Warren. The cochairmen of the Revenue Laws Study Committee established by the Research Commission are Senator A.D. Guy and Representative Daniel T. Lilley. The full membership of the study committee and the staff assigned to the committee is listed in Appendix B of this report. A copy of this report is filed in the Legislative Library. A committee notebook containing the committee minutes and all information presented to the committee is also filed in the Legislative Library.

COMMITTEE PROCEEDINGS

The Legislative Research Commission's Revenue Laws Study Committee met nine times; five meetings were held before the 1986 Legislative Session, and four meetings were held after that session. In addition to these meetings, the Revenue Laws Study Committee met briefly with the Property Tax System Study Committee before the 1986 Session so that each committee could apprise the other of its work. Before the 1986 Session the committee devoted its time to considering numerous small changes in the revenue laws. After the 1986 Session the committee continued its consideration of various small changes in the revenue laws and also considered the major issues of permitting joint rather than combined individual income tax returns and the effects of the federal Tax Reform Act of 1986.

The committee made an interim report to the 1986 Session that contains twenty-one proposed bills. The interim report includes an explanation and a fiscal note for each of the twenty-one proposed bills and is on file in the Legislative Library. Seventeen of the twenty-one proposals made by the committee to the 1986 Session were enacted. Because the bills proposed in the interim report are discussed fully in that report, they are neither listed nor discussed in this report unless they were not enacted in the 1986 Session and are recommended to the 1987 Session. Of the four proposals in the interim report that were not enacted, only the proposal

concerning sales tax on advertising is recommended by the committee to the 1987 Session and is therefore included in this, its final report.

As noted above, the committee spent a significant amount of its time after the 1986 Session considering joint individual income tax returns and the Tax Reform Act of 1986. The committee found that the major impediment to adopting a joint return is the \$1,100 personal exemption granted to the second spouse of a two-wage-earner married couple and learned that this exemption was granted because of the peculiar wording of the North Carolina constitutional provision on income taxes from 1919 to 1971. The committee discussed several proposals made by the staff for adjusting the personal exemptions, the standard deduction, the tax brackets, and the low-income tax credit to achieve a joint return. In reviewing these proposals, the committee realized that it is impossible to switch to a joint return without either losing millions of dollars in tax revenue or increasing the amount of tax owed by some taxpayers while decreasing the amount of tax owed by others. Because of these consequences, the committee did not select a proposal to recommend to the 1987 Session. The committee remains interested in this issue, however.

The second major issue considered by the committee after the 1986 Session was the effect of the Tax Reform Act of 1986. Representatives from the North Carolina Association of Certified Public Accountants briefed the committee on the most significant changes made by that act, and the staff also explained the

significant changes made by that act. Appendix C contains two tables prepared by the staff comparing the old federal law with the Tax Reform Act.

In discussing the Tax Reform Act, the committee considered whether the Internal Revenue Code reference date to which state corporate income tax and some individual income tax provisions are tied should be updated to cover the Tax Reform Act. The committee decided that the reference date should be updated, but viewed this decision as one making a technical change in the tax laws.

As in the past, the committee proved to be an excellent forum for taxpayers and tax administrators to propose changes in the revenue laws. Numerous taxpayers either appeared before the committee or wrote to the committee and suggested changes in the revenue laws. Topics brought to the attention of the committee by concerned taxpayers include:

1. Property tax on goods stored in a private warehouse for shipment outside the State;
2. Sales tax on diesel fuel used by railroad locomotives;
3. Sales tax on advertising;
4. The income tax deduction for expenses to maintain a parent; and
5. Income tax on pensions of retired federal employees.

The committee made recommendations on some of these issues, such as the income tax deduction for expenses to maintain a parent, and decided to take no action on others, such as sales tax on fuel used by railroads.

The Department of Revenue also made numerous proposals to the committee to improve the administration of the revenue laws and to make the laws easier for taxpayers to understand. The committee adopted all of the Department's proposals. The recommendations of the Department of Revenue are contained in Legislative Proposals 3 through 12 of this report.

Appendix D lists the speakers at the committee meetings and the subject of their presentation. The list does not include personnel in the Department of Revenue, who explained the Department's proposals and frequently answered questions raised by committee members on various subjects. The committee expresses its appreciation for the assistance of Ms. Helen Powers, Secretary of Revenue, Mr. Myron Banks, Deputy Secretary of Revenue, and the staff of the Revenue Department.

COMMITTEE RECOMMENDATIONS AND LEGISLATIVE PROPOSALS

The committee recommends the following legislation to the 1987 General Assembly. The committee's legislative proposals consist of sixteen bills and one resolution. The proposals cover a broad range of topics, including an expansion of the income tax deduction for expenses to maintain a parent, a property tax exemption for goods stored in a private warehouse for shipment outside the State, a modification in the method of imposing sales tax on items produced by advertising agencies, and numerous technical and clarifying amendments to the revenue laws. Each proposed bill is followed by an explanation of the proposal and a fiscal note indicating the anticipated revenue gain or loss resulting from the proposal. The proposed resolution is followed by an explanation.

In addition to the bills and the resolution proposed by the committee, the committee recommends two issues to the 1987 General Assembly for which the committee did not adopt a bill. First, the committee recommends that the 1987 General Assembly consider increasing the amount of federal retirement pay and military pay that is exempt from income tax. Currently under G.S. 105-141(b) (14) and (b) (18), \$3,000 of this pay is excluded from income. The committee did not recommend a bill on this subject because the subject was raised at the committee's final meeting and also because the committee anticipates that numerous

bills will be introduced on this subject anyway in the 1987 Session. Instead of simply increasing the \$3,000 limit to a higher limit, the committee urges the General Assembly to consider a graduated exclusion like the one in House Bill 188 of the 1985 Session, consider reducing the amount of any increased exclusion by the amount of social security benefits received, or both.

Second, the committee recommends that the 1987 General Assembly consider ways to relieve elderly people who employ domestic help to assist in their care from the burden of filing various tax forms in connection with their domestic help. Often, these people do not have the ability to submit the proper information and returns. This issue was brought to the committee's attention by a person whose parents are in this situation. That person urged the committee to consider exempting his parents and others similarly situated from making unemployment insurance contributions because they employed domestic help.

LEGISLATIVE PROPOSAL 1

A BILL TO BE ENTITLED

AN ACT TO REPEAL OBSOLETE LOCAL ACTS CONCERNING PROPERTY TAXES.

The General Assembly of North Carolina enacts:

Section 1. Chapter 43 of the 1971 Session Laws is repealed.

Sec. 2. Chapter 557 of the 1973 Session Laws is repealed.

Sec. 3. Chapter 1110 of the 1979 Session Laws, Second Session 1980, is amended by rewriting G.S. 105-316.9(c) set forth in Section 1 of that act, to read:

"(c) This section applies only to Forsyth and Pasquotank Counties."

Sec. 4. Chapter 253 of the 1981 Session Laws is repealed.

Sec. 5. This act is effective upon ratification.

Explanation of Proposal 1

This proposal repeals local acts that are no longer needed because of changes in the property tax laws. The local acts affected by this proposal concern either tax lien sales, which have been abolished, or requirements whose primary purpose was to enable a tax supervisor to locate persons who own household personal property, which is now exempt from tax.

Sections 1 and 2 repeal obsolete local acts concerning tax lien sales. Section 1 repeals Chapter 43 of the 1971 Session Laws. That act permitted Forsyth County and the municipalities located in that county to exempt themselves from the requirement of selling tax liens on real property before the Machinery Act was rewritten in 1971. Section 2 repeals Chapter 557 of the 1973 Session Laws. That act extends the authority given to Forsyth County and its municipalities in the 1971 act to sales of tax liens made after the 1971 Machinery Act revision and grants Cumberland County, Mecklenburg County, and their municipalities the authority to exempt themselves from the requirement of selling tax liens on real property. Because Chapter 808 of the 1983 Session Laws abolished the sale of tax liens on real property, these acts are no longer needed.

Sections 3 and 4 delete several counties from the list of counties in Chapter 1110 of the 1979 Session Laws, Second Session 1980, and in Chapter 253 of the 1981 Session Laws. Those acts

require apartment owners in the listed counties to furnish their tax supervisor with an annual list of their tenants indicating whether the tenants rent a furnished or an unfurnished apartment. The primary purpose of this requirement is to enable the tax supervisor to locate taxpayers who may owe tax on their household personal property. Because Chapter 982 of the 1985 Session Laws, Regular Session 1986, repealed the tax on household personal property, many of the listed counties consider these acts unnecessary.

Every county listed in these acts was asked whether it wanted to continue to require apartment owners to furnish lists of tenants to the tax supervisor. Two of the counties, Pasquotank and Forsyth, stated that the lists served other purposes, such as locating delinquent taxpayers, and that they wanted to retain these requirements. The other counties, Mecklenburg, Dare, and Catawba, stated that in light of the repeal of the tax on household personal property, the lists were no longer useful and they wanted to repeal the requirements. Accordingly, Section 3 rewrites the provision in Chapter 1110 that specifies the counties to which the act applies to delete Dare County and add Forsyth County so that the act applies only to Pasquotank and Forsyth Counties. Section 4 repeals the act that applies to Mecklenburg and Catawba Counties.

Proposal 1

Fiscal Report
Fiscal Research Division
December 3, 1986

Summary of Proposal

This proposal repeals obsolete local acts concerning the now abolished sale of tax liens on real property and repeals the requirement imposed by some counties on apartment owners to furnish lists of tenants to enable the tax supervisor to identify taxpayers who have now tax-exempt household personal property.

Effective Date

Upon ratification

Fiscal Effect

None. The proposal will save apartment owners the trouble and expense of providing lists that serve no useful purpose.

Legislative Proposal 2

A BILL TO BE ENTITLED

AN ACT MAKING ADVERTISING AGENCIES LIABLE FOR SALES TAX ON ALL
ITEMS PURCHASED BY THEM AND EXCLUDING ITEMS PRODUCED BY
ADVERTISING AGENCIES FROM SALES TAX, THEREBY ENSURING THAT
ADVERTISING SERVICES ARE NOT SUBJECT TO SALES TAX.

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-164.3(3) is amended by adding a
new sentence at the end of that subdivision to read:

"An advertising agency is considered the consumer of all
tangible personal property it purchases."

Sec. 2. G.S. 105-164.13 is amended by adding a new
subdivision to read:

"(40) Sales of tangible personal property by an advertising
agency to a client in connection with advertising services
provided to the client by the agency. This subdivision does not
exempt tangible personal property used or consumed by an ad-
vertising agency from the taxes imposed by this Article."

Sec. 3. This act shall become effective July 1, 1987.

Explanation of Proposal 2

This bill changes the way items of tangible personal property produced by an advertising agency, in the course of rendering advertising services to a client, are taxed under the sales tax law. The bill requires an advertising agency to pay sales tax on all items of property purchased by it, even if these items are to be used in producing a product for a client, and exempts items delivered by the advertising agency to its client from sales tax. By making all sales to an advertising agency retail sales and excluding sales by an advertising agency to a client from sales tax, the bill ensures that advertising services are not subject to sales tax and that sales tax is paid on the paper and other supplies that are used by an advertising agency in designing a product for a client.

Under current law, the way sales tax is applied to items of tangible personal property produced by an advertising agency for a client depends on what is done with the item. If an agency prepares and places an ad in a newspaper, for example, no sales tax is charged. If the layout for the ad is delivered to the client, however, for the client to place in a newspaper, all the agency's charges for the ad, including its professional services for formulating the ad, are subject to sales tax. Frequently, it is impossible to tell what portion of professional services provided by the agency to the client are attributable to the ad

because the ad is only a small part of a promotional campaign to which hundreds of hours of market research, consultation, and design have been devoted. Likewise, because some items produced by an advertising agency are taxable and some are not, it is impossible for an advertising agency to know at the time it purchases supplies whether or not these supplies later will be used in a taxable transaction and are, thus, exempt from sales tax at the time of the agency's purchase.

This bill resolves the confusion that currently surrounds the application of sales tax to items produced by advertising agencies and treats advertisers like other taxpayers who are similarly situated by excluding services provided by advertising agencies from sales tax. The committee recognizes that although an advertising agency's work may result in the transfer of a tangible item to a client, such as a layout for an ad or a brochure, the great majority of the client's bill is for market research, advertising strategies, media placement, and creative services, and that transfer of a tangible item is incidental to providing the services. In this respect, the committee finds that advertising agencies are more like lawyers and other professionals whose primary function is providing services than they are like merchants selling goods off the shelf and should be treated as such under the sales tax law.

Fiscal Report
Fiscal Research Division

Proposal 2

Summary of Proposal

This proposal excludes advertising agencies from collecting sales tax on any of their products and requires that they pay sales tax on merchandise they purchase.

Related Information

Currently, if an advertising agency delivers a product to the client, and the client uses the product howsoever he chooses, then the agency is responsible for collecting sales tax on the product. The advertising product is considered to be tangible personal property and, therefore, subject to the State and local sales tax.

If the agency produces the same product but, instead of delivering it to the client, places it in the media on behalf of the client, then no sales tax is collected. For instance, Agency X produces an ad for Tax and Investment Company B. The agency decides that the best way to use this ad is in a full-page spread in a statewide business magazine during the months of November through February. Agency X runs the ad with the magazine during the appropriate times and places. No sales tax is collected on the ad because it is considered to be a part of an "advertising service" and, as such, not subject to the sales tax.

The responsibility for collecting sales tax on some of its products, and not all, has been cumbersome and confusing to the advertising industry. This proposal remedies that situation.

Effective Date

July 1, 1987

Fiscal Effect

The Department of Revenue, based on a review of sales tax returns, estimates that the enactment of the proposal would reduce General Fund tax revenue by \$1.5 million dollars (1986-87) per year and would reduce local sales tax revenue by approximately \$1.0 million per year (assuming all 100 counties have adopted the 1/2% sales tax authorized by the 1986 General Assembly).

Legislative Proposal 3

A BILL TO BE ENTITLED

AN ACT TO ELIMINATE SEASONAL PRIVILEGE LICENSES.

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-33 is amended by deleting subsection (k) of that section.

Sec. 2. This act shall become effective June 1, 1987.

Explanation of Proposal 3

This bill eliminates seasonal privilege licenses. These licenses are difficult to administer, are obsolete, and cannot be enforced cost-effectively. Only 217 seasonal licenses were issued for 1985-86, which is .32% of the number of businesses that could possibly qualify for a seasonal license.

Under current law, a handful of the more than fifty businesses required to obtain an annual privilege license, for which a license tax is imposed, may obtain a seasonal license instead of an annual license. The businesses that may obtain a seasonal license are hotels, restaurants, drug stores, and businesses that sell various items through dispensing machines. To qualify for a seasonal license, one of these businesses must be located at a winter resort or a summer resort and must be operated only for the winter or summer season. A summer seasonal license authorizes a business to operate from June 1 to October 1, and a winter seasonal license authorizes a business to operate from December 1 to April 1. The tax for a seasonal license is one-half the amount for an annual license.

The seasonal license is difficult to administer because the periods for the license do not correspond to the length of time that businesses operated at resorts stay open, the periods overlap the normal license year and half-year, and the determination of what is and is not a resort area is often difficult to make. The seasonal license tax was first enacted in

1935 and generally applied to the same group of businesses to which it currently applies. When it was enacted, however, the license year ran from June 1 to May 31 instead of from July 1 to June 30. Thus, rather than overlapping the license year, as the summer seasonal license now does, it permitted the business to operate for only the first four months of the license year at one-half the annual rate. Similarly, the winter seasonal license permitted the business to operate for the first four months of the second half of the license year at one-half the annual rate and corresponded to the reduced tax charged for a business that began its operation in the second half of the fiscal year. The license year changed from the period June 1 to May 31 to the period July 1 to June 30 in 1963.

Proposal 3

Fiscal Report
Fiscal Research Division
December 3, 1986

Summary of Proposal

This proposal eliminates seasonal privilege licenses available to hotels, restaurants, drug stores, and a few other businesses that are located at a winter or summer resort and are operated only for the period December 1 to April 1 or the period June 1 to October 1. At issue is the reasonableness of the seasonal license and the cost effective enforcement of the license. Seasonal licenses comprise .32% of the licenses issued to businesses that could qualify for them.

Effective Date

June 1, 1987

Fiscal Effect

Approximately \$3,600 increase in State revenue.

Legislative Proposal 4

A BILL TO BE ENTITLED

AN ACT TO PERMIT ALCOHOLIC BEVERAGE LICENSEES WHO ARE REQUIRED TO FURNISH A BOND TO PLEDGE GOVERNMENT BONDS AS COLLATERAL RATHER THAN OBTAIN A BOND FROM A CORPORATE SURETY.

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-113.86 is amended as follows:

- (1) by deleting the phrase ", secured by a corporate surety," each time it appears in that section; and
- (2) by rewriting the second sentences of subsections (a) and (b) to read:

"The bond shall be conditioned on compliance with this Article, shall be payable to the State, shall be in a form acceptable to the Secretary, and shall be secured by a corporate surety or by a pledge of obligations of the federal government, the State, or a political subdivision of the State."

Sec. 2. This act is effective upon ratification.

Explanation of Proposal 4

As the title indicates, this bill permits those alcoholic beverage licensees who are required to furnish a bond to the Department of Revenue to cover alcoholic beverage taxes payable by them to pledge government bonds as collateral rather than furnish a bond. Some of these licensees are finding it extremely difficult to obtain a bond from a corporate surety, as required by G.S. 105-113.86, because the insurance industry is not offering these types of bonds. To alleviate this problem, the bill permits those licensees required to furnish a bond to pledge obligations of the State, a local governmental unit of the State, or the United States instead.

Currently, malt beverage wholesalers, wine wholesalers, malt beverage importers, and wine importers must furnish a bond of up to \$50,000 to cover their potential liability for beer and wine taxes. The bond is proportioned to the amount of tax collected by them, and the majority of bonds required ranges from \$25,000 to \$40,000. Nonresident malt beverage vendors and nonresident wine vendors do not always have to furnish a bond. The Secretary of Revenue, however, can require them to furnish a bond of up to \$2,000.

Proposal 4

Fiscal Report
Fiscal Research Division
December 3, 1986

Summary of Proposal

The proposal permits malt beverage or wine wholesalers or importers and nonresident malt beverage or wine vendors to pledge government obligations as collateral rather than furnish a bond secured by a corporate surety to cover their potential liability for beer and wine taxes.

Effective Date

Upon ratification

Fiscal Effect

None

Legislative Proposal 5

A BILL TO BE ENTITLED
AN ACT TO MAKE THE LAW CONCERNING STATE PRIVILEGE LICENSE TAXES
ON GUN DEALERS MORE EQUITABLE.

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-80 is rewritten to read:

"§ 105-80. Firearms dealers and dealers in other weapons.--(a) Firearms. Every person, firm, or corporation who is engaged in the business of selling or offering for sale firearms, other than antique firearms or firearms that are weapons of mass death and destruction, shall obtain a license from the Secretary of Revenue for the privilege of engaging in business and shall pay a tax of fifty dollars (\$50.00) for the license. As used in this subsection, the terms "antique firearm" and "weapons of mass death and destruction" have the same meanings as in G.S. 14-409.11 and 14-288.8, respectively.

A license issued under this subsection authorizes the licensee to engage in business at the location for which the license is issued and at a gun show held in the State. A "gun show" is an event sponsored either by an organization devoted to the collection, competitive use, or other sporting use of firearms or by an organization that sponsors events devoted to the collection, competitive use, or other sporting use of firearms in the community.

(b) Other Weapons. Every person, firm, or corporation who is engaged in the business of selling or offering for sale bowie knives, dirks, daggers, leaded canes, iron or metallic knuckles, or similar weapons shall obtain a license from the Secretary of Revenue for the privilege of engaging in business and shall pay a tax of two hundred dollars (\$200.00) for the license.

(c) Local Licenses. Counties and cities may levy a license tax on a business taxed under this section at an amount that does not exceed the State tax."

Sec. 2. This act shall become effective July 1, 1987.

Explanation of Proposal 5

This bill rewrites G.S. 105-80, the statute that imposes a privilege license tax on pistol dealers and dealers in certain knives and other weapons, to conform the gun provisions of the statute to federal law concerning the licensing of firearms dealers. It does not change the provisions concerning knives and other weapons, such as metallic knuckles. It repeats those provisions because it rewrites the entire statute. The bill conforms the gun provisions of the statute to federal law to make the statute easier to administer and, more importantly, to address the many complaints the Department receives about the inequity of the current provision.

Currently, G.S. 105-80 requires persons who are engaged in the business of selling pistols, including blank cartridge pistols, to pay an annual license tax of \$50.00 and requires a person who is engaged in the business of selling metallic cartridges to pay an annual license tax of \$5.00. A person who sells both pistols and metallic cartridges, however, pays only fifty dollars (\$50.00). The statute, therefore, does not apply to everyone who sells guns and ammunition. It does not apply to persons who sell rifles or shotguns or to persons who sell ammunition, such as shotgun shells, that is not composed of a metallic cartridge.

In addition to not applying uniformly to all dealers in guns and ammunition, the statute does not conform to federal firearms

licensing requirements. Under federal law, dealers in long guns as well as pistols must purchase a firearms license. Also, dealers in antique firearms, destructive devices, and ammunition are exempt from the firearms licensing requirements. Dealers in destructive devices, such as machine guns, are subject to other licensing requirements, however.

The discrepancy in State and federal law on this subject confuses many and provides an explanation for why only 3618 of the 6700 federal firearms licensees in North Carolina have a State privilege license. Although the federal firearms license is a business license, many of the federal licensees do not have retail stores and, when questioned by the Department of Revenue about why they do not have a State privilege license, report that they do not sell long guns.

As stated, the bill conforms the State privilege license to the federal firearms license, thereby requiring all gun dealers, except dealers in antique firearms and firearms considered to be destructive devices, which under State nomenclature are weapons of mass death and destruction, to pay an annual privilege license tax. In conforming to federal law, the bill exempts dealers in only ammunition from the tax and permits a licensee to sell guns at the location for which the license is issued and also at a gun show. Under current law, a pistol dealer is required to purchase an additional privilege license to sell at a gun show because the license is specific to one particular location.

As under the current statute, the bill permits counties and cities to levy a privilege license tax on businesses taxed under

the proposed statute at a rate not to exceed the State tax.

Because the bill extends the tax to include dealers in long guns as well as pistols, the authority of counties and cities to levy privilege license taxes on these dealers is similarly extended.

Proposal 5

Fiscal Report
Fiscal Research Division
December 3, 1986

Summary of Proposal

This proposal extends the privilege license tax on pistol dealers to include dealers who sell rifles or shotguns, repeals the privilege license tax on dealers in metallic cartridges, and exempts dealers in antique firearms from the tax. In so doing, the proposal conforms the State privilege tax to federal firearms licensing requirements.

Effective Date

July 1, 1987

Fiscal Effect

Approximately \$85,000 increase in State revenue

Legislative Proposal 6

A BILL TO BE ENTITLED

AN ACT TO TRANSFER THE RESPONSIBILITY FOR ISSUING BINGO LICENSES
AND ESTABLISHING AUDIT PROCEDURES FOR BINGO ACCOUNTS FROM THE
DEPARTMENT OF REVENUE TO THE ATTORNEY GENERAL'S OFFICE.

The General Assembly of North Carolina enacts:

Section 1. G.S. 14-309.7(a) is amended by deleting the
first sentence of that subsection and substituting the following:

"An exempt organization may not operate a bingo game at a
location without a license. Application for a bingo license
shall be made to the Office of the Attorney General on a form
prescribed by that office.

Sec. 2. G.S. 14-309.7(e) is amended as follows:

(1) by rewriting the first sentence of that subsection
to read: "An exempt organization that wants to conduct only an
annual or semi-annual bingo game may apply to the Office of the
Attorney General for a limited occasion permit.";

(2) by deleting the words "Department of Revenue" in
the second and sixth sentences of that subsection and
substituting the words "Office of the Attorney General";

(3) by deleting the word "Department" in the third
sentence of that subsection and substituting the words "Office of
the Attorney General"; and

(4) by deleting the word "single" each time it appears
in that subsection and substituting the word "limited".

Sec. 3. G.S. 14-309.11(b) and (d) are each amended by deleting the words "Department of Revenue" and substituting the words "Office of the Attorney General".

Sec. 4. This act shall become effective July 1, 1987, and shall apply to applications to renew a bingo license or obtain a new license made on or after that date.

Explanation of Proposal 6

This bill transfers the responsibility for issuing bingo licenses and establishing accounting procedures to be used in auditing bingo accounts from the Department of Revenue to the Attorney General's Office. Currently, under G.S. 14-309.7, the Department of Revenue is responsible for issuing all bingo licenses even though bingo licenses are not subject to a tax and are, therefore, not revenue licenses. Current law also requires the Department of Revenue to develop forms to be used in auditing bingo accounts and to determine the audit schedule for bingo accounts. As with the requirement of issuing bingo licenses, this task consumes resources of the Department of Revenue that could be devoted to a revenue producing task.

The bill transfers these responsibilities to the Attorney General's Office, which is a more appropriate agency for these responsibilities. Most of the questions the Department of Revenue receives about bingo concern the enforcement of the bingo laws and not the license itself. These questions are referred to the Attorney General's Office, which is obviously the appropriate agency to answer questions about enforcement. Even if a tax were charged for a bingo license, the Attorney General's Office rather than the Department of Revenue is the more appropriate agency to license bingo because the license is the means by which bingo is regulated and is not intended to produce revenue.

The committee proposed a similar bill to the 1985 General Assembly. That proposal passed the House but did not pass the Senate, primarily because of opposition from the Attorney General's Office. That Office reported to the committee that it is willing to assume responsibility for licensing bingo, but needs an appropriation of \$120,000 to perform the task. The bill does not contain an appropriation, however. The Department of Revenue did not receive an additional appropriation when the responsibility was assigned to it. The committee therefore declined to propose an appropriation to the Attorney General's Office. If the bill is enacted, the committee anticipates that the additional cost incurred by that Office will be included in the Office's continuation budget request.

Proposal 6

Fiscal Report
Fiscal Research Division
December 3, 1986

Summary of Proposal:

Transfers the responsibility for issuing bingo licenses and establishing auditing procedures for bingo accounts from the Department of Revenue to the Attorney General's Office.

Effective Date:

Licenses issued or renewed on or after July 1, 1987

Fiscal Effect:

None. Would free-up Department of Revenue personnel to perform other functions that product tax collections.

Legislative Proposal 7

A BILL TO BE ENTITLED
AN ACT TO ELIMINATE THE REQUIREMENT THAT A NONRESIDENT RETAIL OR
WHOLESALE MERCHANT REGISTER WITH THE DEPARTMENT OF REVENUE FOR
SALES TAX PURPOSES.

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-164.3(10) is rewritten to read:

"(10) 'Nonresident retail or wholesale merchant' means a person who does not have a place of business in this State, is engaged in the business of acquiring, by purchase, consignment, or otherwise, tangible personal property and selling the property outside the State, and is registered for sales and use tax purposes in a taxing jurisdiction outside the State."

Sec. 2. This act is effective upon ratification.

Explanation of Proposal 7

This bill rewrites the definition of "nonresident retail or wholesale merchant" in the sales tax statutes to eliminate the requirement that a nonresident merchant register with the Department of Revenue and obtain a sales tax number. The bill replaces this requirement with a requirement that the merchant be registered for sales and use tax purposes in a taxing jurisdiction outside the State. Thus, under the bill, when a nonresident merchant buys goods in this State to be resold, either at wholesale or retail, outside the State the merchant will give the person from whom he purchases the goods the merchant's sales tax number in the other jurisdiction, and the merchant will not have to have previously registered with the Department of Revenue to purchase goods in this State for resale outside the State.

Eliminating the requirement that a nonresident merchant who is registered in another state also register with the Department of Revenue will eliminate considerable paperwork by these merchants and the Sales and Use Tax Division of the Department of Revenue. It will also expedite wholesale sales by resident merchants to nonresident merchants and will save processing time and space in the Sales and Use Tax Division.

Proposal 7

Fiscal Report
Fiscal Research Division
December 3, 1986

Summary of Proposal

This proposal repeals the requirement that a nonresident merchant who is registered for sales and use tax purposes in a taxing jurisdiction outside this State obtain a sales tax number from the Department of Revenue.

Effective Date

Upon ratification

Fiscal Effect

None. The bill will not affect the Department of Revenue's ability to audit transactions between resident and nonresident merchants.

Legislative Proposal 8

A BILL TO BE ENTITLED

AN ACT TO CLARIFY THE SALES TAX EXEMPTION FOR MATERIALS USED TO
CONSTRUCT OR REPAIR CERTAIN FARM BUILDINGS.

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-164.13(4c), as enacted by Chapter 973 of the 1985 Session Laws (Reg. Sess. 1986), is rewritten to read:

"(4c) Building materials, supplies, and fixtures used in the construction, repair, or improvement of any enclosure or structure specifically designed, constructed, and used for commercial purposes for housing, raising, or feeding livestock or poultry or for housing equipment necessary for these activities, including work space used solely for these commercial activities. This exemption does not apply to items that are subject to the one percent (1%) rate of tax under G.S. 105-164.4(1)g., m., n., or o."

Sec. 2. This act is effective upon ratification.

Explanation of Proposal 8

As the title indicates, this bill clarifies the exemption enacted in the 1986 Session for materials used to construct or repair certain farm buildings. The bill makes clear that the exemption applies only to building materials and that it applies only to materials that are not taxed at a rate of 1% under G.S. 105-164.4(1)g., m., n., or o. The discussions of the bill in the 1986 Session focused only on building materials and materials, like lumber, that are taxed at the full rate instead of a reduced rate. Thus, the bill effectuates the intent of the 1986 act and is in accord with the interpretation of the exemption made by the Department of Revenue in administering the exemption.

Proposal 8

Fiscal Report
Fiscal Research Division
December 3, 1986

Summary of Proposal

This proposal makes clarifying amendments to the sales tax exemption for materials used to construct or repair farm buildings enacted in the 1986 Session.

Effective Date

Upon ratification

Fiscal Effect

None

Legislative Proposal 9

A BILL TO BE ENTITLED

AN ACT TO CONFORM THE PENALTIES FOR LATE PAYMENTS OF INHERITANCE
TAX TO THOSE APPLICABLE TO LATE PAYMENTS OF ALL OTHER TAXES.

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-16 is rewritten to read:

"§ 105-16. Report and payment of taxes.--Taxes imposed by this Article are due and payable within nine months of the date of death of the decedent. Interest accrues on taxes not paid within this nine-month period at the rate established under G.S. 105-241.1(i), computed from the date the nine-month period ends. Taxes not paid within the later of nine months after the date of the decedent's death or nine months after the date of the qualification of the personal representative of the decedent's estate are subject to the penalties provided in G.S. 105-236."

Sec. 2. This act shall become effective July 1, 1987, and shall apply to the estates of decedents dying on or after that date.

Explanation of Proposal 9

This bill makes the penalties for late payments of inheritance taxes the same as for late payments of all other taxes collected by the Department of Revenue, thereby giving persons who owe delinquent inheritance taxes more incentive to pay these delinquent taxes. Currently, late payments of inheritance tax are subject to a penalty of 5% of the amount of tax due. No additional penalty can be assessed once the 5% penalty is imposed. Late payments of other taxes, however, are subject to a penalty of 5% of the amount of tax due for each month the taxes are late. Thus, unlike a taxpayer who owes late income taxes, a taxpayer who owes delinquent inheritance taxes has no incentive to pay the taxes once they are late and the 5% penalty is imposed. This bill solves this problem by making late inheritance tax payments subject to the same 5% monthly penalty as other late tax payments.

In conforming the inheritance tax statute to the general law on penalties for late payments of taxes, the bill deletes unnecessary or repetitive verbiage in the statute. The bill makes no change in the current law, however, other than to change the penalties applicable to late payments of inheritance taxes.

Proposal 9

Fiscal Report
Fiscal Research Division
December 3, 1986

Summary of Proposal

This proposal conforms the penalties for late payments of inheritance tax to the penalties for late payments of all other taxes collected by the Department of Revenue.

Effective Date

July 1, 1987, and applies to the estates of decedents dying on or after that date

Fiscal Effect

Very negligible increase in State revenue

Legislative Proposal 10

A BILL TO BE ENTITLED

AN ACT MAKING TECHNICAL AND CLARIFYING AMENDMENTS TO THE REVENUE LAWS.

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-24 is amended as follows:

- (1) by deleting the words "which would thereafter be assessed thereon under this Article" in the first sentence of that section and substituting the words "assessed under this Article on property transferred by the decedent";
- (2) by deleting the phrases "under the provisions of G.S. 41-2.1" and "against such deposit or stock" in the first sentence of the second paragraph of that section;
- (3) by deleting the phrase "such taxes as may be due on such deposit or stock are paid, or when" in the second sentence of the second paragraph of that section; and
- (4) by deleting the phrase "the succession to such securities, deposits, assets, or property, but in" in the third paragraph of that section and substituting the phrase "property transferred by the decedent. In".

Sec. 2. G.S. 105-130.4 is amended by inserting a new subsection (s) to read as follows and by relettering the succeeding subsection accordingly:

"(s) All business income of an air or water transportation corporation shall be apportioned by a fraction, the numerator of

which is the corporation's revenue ton miles in this State and the denominator of which is the corporation's revenue ton miles everywhere. The term "revenue ton mile" means one ton of passengers, freight, mail, or other cargo carried one mile. In making this computation, a passenger is considered to weigh two hundred pounds."

Sec. 3. G.S. 105-130.5(c) (3) is rewritten to read:

"(3) No deduction is allowed for any direct or indirect expenses related to income not taxed under this Division."

Sec. 4. G.S. 105-130.10 is amended by deleting the last sentence of that section.

Sec. 5. G.S. 105-147(13) is amended by deleting the sentence immediately preceding paragraph c. of that subdivision.

Sec. 6. G.S. 105-213(a) is amended by rewriting the second paragraph of that subsection to read:

"In determining the amount to be distributed, the Secretary shall deduct from the net amount of taxes collected under this Article, which is the total amount collected less refunds, the cost to the State for the preceding fiscal year to:

- (1) Collect and administer the taxes levied under this Article;
- (2) Perform the duties imposed upon the Department of Revenue by Article 15 of this Chapter;
- (3) Operate the Property Tax Commission; and
- (4) Operate a training program in property tax appraisal and assessment administration by the Institute of Government."

Sec. 7. Notwithstanding Section 6 of this act, in determining the amount to be distributed under G.S. 105-213 for the fiscal year ending June 30, 1987, the Department of Revenue shall deduct all tax credits allowed under G.S. 105-122(d) during that fiscal year.

Sec. 8. G.S. 105-228.9 is rewritten to read:

"§ 105-228.9. Commissioner of Insurance to administer Article.--This Article shall be administered solely by the Commissioner of Insurance, who has the same authority and responsibility in administering this Article as the Secretary of Revenue has in administering the other Articles of this Chapter. All provisions of this Chapter that are not inconsistent with this Article apply to this Article."

Sec. 9. This act is effective upon ratification.

Explanation of Proposal 10

This proposal makes various technical or clarifying amendments to the revenue laws. The technical amendments in this proposal delete obsolete provisions in the law or correct statutory or other references. The clarifying amendments rewrite existing provisions or add new provisions to make explicit the accepted interpretation of a provision or the administrative practice.

Section 1 makes two changes to G.S. 105-24, the inheritance tax statute requiring financial institutions to retain property owned jointly by a decedent and others for payment of inheritance taxes. First, it clarifies that jointly owned property retained by a financial institution upon the death of one of the joint owners may be applied to the payment of all inheritance taxes due on property transferred by the deceased joint owner and not just on the property retained by the institution. Although the wording of the statute suggests that property retained by an institution may be applied only to unpaid inheritance taxes on the retained property, the statute has always been interpreted to permit the retained property to be applied to any unpaid inheritance taxes due on property transferred by the deceased joint owner.

Second, Section 1 deletes a reference to G.S. 41-2.1, which sets out a procedure for two or more people to establish a joint deposit account with right of survivorship, to make clear that a financial institution may release one-half of the amount on

deposit in a joint account created by a means other than that prescribed by G.S. 41-2.1, as well as one-half of the amount in an account created under that statute. Although most joint deposit accounts are established in accordance with that statute, it is not the only way to establish a joint account with right of survivorship.

Section 2 adds a subsection to G.S. 105-130.4, which specifies how the income of a multi-state business is to be allocated and apportioned to this State, to state the method for apportioning the income of an air or water transportation company. It states that the income of this type company is to be apportioned on the basis of revenue ton miles. Although the statutes do not currently set forth this method, it is the method used by the Department of Revenue.

Section 3 rewrites G.S. 105-130.5(c) (3), which requires corporations to add certain items deductible in determining federal taxable income to their State taxable income, to make clear that a corporation must add to its federal taxable income any deductions for expenses related to income that is not taxed by the State that the corporation took in computing its federal taxable income. For example, many corporations incur expenses in connection with investments in bonds that are not taxable by the State or with stocks that produce dividend income that is not taxed by the State. This subdivision disallows the deduction for these expenses. Although the wording of the current statute suggests that a deduction is disallowed only for expenses incurred in connection with nontaxable dividend income, by

administrative practice all deductions for expenses incurred in producing nontaxable income are disallowed.

Sections 4 and 5 delete obsolete corporate and individual income tax provisions concerning the amortization of air-cleaning devices, waste treatment facilities, and recycling facilities. The deleted provisions give a company that installed equipment before 1955 the option to amortize the equipment over 5 years instead of depreciating it. Because of the reference to 1955, the provisions are no longer meaningful. Although the provision in the corporate income tax statutes appears to apply to equipment installed after 1955 instead of before, the word "before" in that statute was mistakenly changed to "after" in 1969 and was never corrected. The individual income tax provision states that the equipment must have been installed before 1955.

Section 6 deletes obsolete references in the list of items that are to be deducted by the Department of Revenue from intangibles tax revenue collected by the Department before distributing the revenue to cities and counties. It deletes a reference to the Ad Valorem Tax Division of the Department of Revenue and substitutes a reference to the duties imposed on the Department under Article 15 of Chapter 105. This change is made because the Ad Valorem Tax Division in the Department has been consolidated with the Intangibles Tax Division and is now called the Property Tax Division. To avoid naming a division of the Department, the section refers to the statutes that specify the Department's duties in connection with property taxes.

Section 6 also deletes a reference to the tax credit allowed against the franchise tax for taxes paid on money on deposit. The tax on money on deposit was repealed in 1985.

Section 7 preserves the deductibility of the credit for the repealed tax on money on deposit in making the distribution of intangibles tax revenue. Although the tax on money on deposit was repealed effective for taxable years beginning January 1, 1985, a few credits continue to be taken by taxpayers filing amended returns. Amended returns can be filed for three years.

Section 8 rewrites G.S. 105-228.9, which states the authority of the Commissioner of Insurance to collect and administer the gross receipts tax on insurance companies, to make clear that the Commissioner has the sole authority to administer those taxes. This has been the understanding of the Departments of Revenue and Insurance.

Section 9 specifies that the act is effective upon ratification.

Proposal 10

Fiscal Report
Fiscal Research Division
December 3, 1986

Summary of Proposal

This proposal makes the following technical and clarifying amendments to the revenue laws:

(1) It clarifies that jointly owned property retained by a financial institution upon the death of one of the joint owners may be applied to the payment of all inheritance taxes due on property transferred by the deceased joint owner and not just on the property retained by the institution.

(2) It clarifies that a financial institution can release one-half of the amount of funds on deposit in a joint deposit account with right of survivorship that was created by a method other than that specified in G.S. 41-2.1.

(3) It clarifies how the income of a multi-state air or transportation company is to be allocated and apportioned to this State.

(4) It clarifies that all expenses incurred in connection with income that is not taxed are not deductible.

(5) It deletes obsolete income tax provisions on amortization of certain environmental equipment and facilities.

(6) It deletes obsolete references to items deductible by the Department of Revenue in making the distribution of intangible tax revenue.

(7) It clarifies that the Commissioner of Insurance has the sole authority to administer the gross receipts tax on insurance companies.

Effective Date

Upon ratification

Fiscal Effect

None

Legislative Proposal 11

A BILL TO BE ENTITLED

AN ACT TO UPDATE THE REFERENCE TO THE INTERNAL REVENUE CODE USED
IN DETERMINING CERTAIN TAXABLE INCOME AND TAX EXEMPTIONS, AND
TO MAKE TECHNICAL CHANGES IN THE INCOME TAX STATUTES
NECESSITATED BY THE TAX REFORM ACT OF 1986.

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-2.1, 105-114, 105-130.2(1),
105-135(15), 105-163.1(11), and 105-212 are each amended by
deleting the phrase "January 1, 1986, and includes any provisions
enacted as of that date which become effective after that date"
and substituting the phrase "January 1, 1987, and includes any
provisions enacted as of that date which become effective either
before or after that date".

Sec. 2. G.S. 105-130.5(a) (8) and G.S. 105-130.5(b) (10)
are repealed.

Sec. 3. G.S. 105-130.5(d) is repealed.

Sec. 4. G.S. 105-141.2 and G.S. 105-147(21)b. are each
amended by deleting the phrases "Internal Revenue Code of 1954,
as amended" or "Internal Revenue Code of 1954, as amended," and
substituting the word "Code".

Sec. 5. G.S. 105-163 is rewritten to read:

"§ 105-163. Grantor trusts.-- The grantor of a trust or another person who is treated as the owner of the trust under §§ 671 through 678 of the Code shall, if allowed under Division II of this Article, include in the computation of the amount of tax owed by him under that Division those items of income, deductions, and credits against the tax of the trust that are attributable to the portion of the trust he is considered to own."

Sec. 6. This act is effective upon ratification.

Explanation of Proposal 11

This proposal rewrites the definition of the Internal Revenue Code used in State tax statutes to change the reference date from January 1, 1986, to January 1, 1987, and to include changes made by the Tax Reform Act of 1986 that became effective before that date. It also makes several technical changes needed because of changes made by the Tax Reform Act.

Section 1 rewrites the definition of the Internal Revenue Code as described above. Updating the reference does, of course, make changes made by the Tax Reform Act applicable to the State to the extent State tax law previously tracked federal law. Nevertheless, the committee considers this proposal a technical change to keep the State laws that are intended to track the federal law in step with the changes made by the Tax Reform Act to federal law. This update has the greatest effect on State corporate income taxes because these taxes are a percentage of federal taxable income and are therefore closely tied to federal law. Individual income taxes are not tied to federal law as are corporate income taxes, but many individual income tax deductions are tied to federal. The changes made by the Tax Reform Act are numerous and are significant. Appendix C summarizes these changes.

Since the State corporate income tax was changed to a percentage of federal taxable income in 1967, the reference date to the Internal Revenue Code has been updated periodically. In discussing bills to update the Code reference, the question

frequently arises of why the statutes refer to the Code as it existed on a particular date instead of referring to the Code and any future amendments to it, thereby eliminating the necessity of bills like this. The answer to the question lies in both a policy decision and a potential legal restraint.

First, the policy reason for specifying a particular date is that, in light of the many changes made in federal tax law recently and the likelihood of continued changes, the State may not want to automatically adopt federal changes, particularly when these changes result in large revenue losses. By pinning references to the Code to a certain date, the State ensures that it can examine any federal changes before making the changes effective for the State.

Secondly, and more importantly, however, the North Carolina Constitution imposes an obstacle to a statute that automatically adopts any changes in federal tax law. Article V, § 2(1) of the Constitution provides in pertinent part that the "power of taxation... shall never be surrendered, suspended, or contracted away." Relying on this provision, the North Carolina court decisions on delegation of legislative power to administrative agencies, and an analysis of the few federal cases on this issue, the Attorney General's Office concluded in a memorandum issued in 1977 to the Director of the Tax Research Division of the Department of Revenue that a "statute which adopts by reference future amendments to the Internal Revenue Code would... be invalidated as an unconstitutional delegation of legislative power."

Section 2 deletes two provisions in the corporate income tax statutes rendered obsolete by the Tax Reform Act. Currently, G.S. 105-130.5 permits a corporation to deduct from its federal taxable income costs incurred by it to renovate an existing building or facility to provide the handicapped access to the building or facility or the effective use of the building or facility. To avoid a double deduction for the same expense, current law also requires a corporation that deducts these costs to add back to its federal taxable income any of the same costs that it deducted when computing its federal taxable income. The Tax Reform Act enacted a specific deduction for expenses to provide the handicapped access to and use of buildings. Because corporate income tax is tied to the federal, every corporation will have already deducted these expenses in computing its federal taxable income. The special North Carolina provisions on this subject are therefore no longer necessary.

Section 3 deletes the provision in the corporate income tax law concerning the recognition of gain upon the liquidation of a business to keep State law on this issue in conformity with the changes made by the Tax Reform Act. Before the Tax Reform Act, a corporation that adopted a plan of liquidation under § 337 of the Code and distributed all of its assets within twelve months following the date the plan was adopted did not recognize any gain or loss resulting from the liquidation. The Tax Reform Act changed this to require a corporation to recognize gain or loss upon the distribution of assets in a complete liquidation under § 331, 333, or 337 of the Code. Because our State provision on

liquidations follows the old federal law and not the new, the provision needs to be deleted.

Section 4 changes references to the Internal Revenue Code of 1954, as amended, in two individual income tax provisions concerning alimony and other payments between former spouses to references to the "Code." The more lengthy description is not needed because the term "Code" is defined in the individual income tax statutes and should be used consistently throughout these statutes. Also, with the passage of the Tax Reform Act, this more lengthy description is not accurate. That Act changed the name of the Internal Revenue Code from the Internal Revenue Code of 1954 to the Internal Revenue Code of 1986.

Section 5 rewrites the tax statute concerning grantor trusts to conform to changes in the taxation of income from these trusts made by the Tax Reform Act of 1986. The present statute repeats former provisions of the Internal Revenue Code verbatim. This verbatim repetition is not necessary and has produced the current problem, which is that the federal law it repeats is no longer the law. To solve this problem, the rewritten statute refers only to the appropriate sections of the Code and does not repeat the text of those sections unnecessarily.

Section 6 specifies that the bill is effective upon ratification.

Proposal 11

Fiscal Report
Fiscal Research Division
December 3, 1986

Summary of Proposal

This proposal updates the reference to the Internal Revenue Code used for income tax purposes from January 1, 1986, to January 1, 1987, and deletes or rewrites other income tax provisions that must be changed if the reference date is changed.

Effective Date

Upon ratification

Fiscal Effect

Will generate at least an additional \$20 million dollars annually in State revenue

Legislative Proposal 12

A BILL TO BE ENTITLED

AN ACT TO CONFORM THE TREATMENT OF ALL INCOME TAX CREDITS
RECEIVED BY A CORPORATION TO THE TREATMENT OF AN INCOME TAX
CREDIT FOR PROPERTY TAXES.

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-130.5(a) (10) is amended as follows: (1) by deleting the phrase "amount of property taxes allowed under Division IV of" in the first sentence of that subdivision and substituting the phrase "total amounts allowed under"; and

(2) by deleting the words "this credit" in the second sentence of that subdivision and substituting the phrase "a credit taken under this Article".

Sec. 2. This act is effective for taxable years beginning on or after January 1, 1987.

Explanation of Proposal 12

This proposal requires a corporation to treat all credits taken against its income tax as it treats a credit for property taxes paid on inventory. Under current law, a corporation is required to add to its federal taxable income the amount of a State tax credit for property taxes paid on inventory. If the corporation is a multi-state corporation, it must make the addition after it applies its apportionment factor to its other income. Corporations can receive credits for many expenses other than property taxes paid on inventory. These other credits should be treated the same as property tax credits on inventory to prevent a corporation from both deducting the expense for which the credit is claimed in computing its federal taxable income and receiving a credit from the State for the same expense.

Proposal 12

Fiscal Report
Fiscal Research Division
December 3, 1986

Summary of Proposal

This proposal requires a corporation to add to its federal taxable income the amount of a tax credit allowed by the State to prevent the corporation from having a double deduction. The proposal thus conforms the treatment of all corporate tax credits to the treatment of a tax credit for property taxes paid on inventory.

Effective Date

Taxable years beginning on or after January 1, 1987

Fiscal Effect

Will increase State revenue by approximately \$100,000 annually

Legislative Proposal 13

A BILL TO BE ENTITLED

AN ACT TO CONVERT THE SALES TAX ON CERTAIN UTILITY SERVICES TO A GROSS RECEIPTS TAX.

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-164.3(20) is amended in the second sentence by inserting between the words "include" and "water" the phrase "piped natural gas, electricity, or".

Sec. 2. G.S. 105-164.3(25) is repealed.

Sec. 3. G.S. 105-164.4(1) c., d., and e. are each amended by deleting the phrase ", other than electricity or piped natural gas,".

Sec. 4. G.S. 105-164.4(4a) is repealed.

Sec. 5. The first sentences of G.S. 105-164.14(b) and (c) are each amended by deleting the phrase ", except under G.S. 105-164.4(4a),".

Sec. 6. G.S. 105-164.16 is amended as follows:

- (1) by deleting the word "General" in the heading to subsection (b); and
- (2) by deleting subsection (c).

Sec. 7. G.S. 105-164.20 is amended as follows:

- (1) by deleting the phrase ", except a utility," in the first sentence of that section; and
- (2) by deleting the last two sentences of that section.

Sec. 8. G.S. 105-164.21 is amended as follows:

- (1) by deleting the phrase "Except as provided in subsection (b), a" in the first sentence of subsection (a) and substituting the word "A"; and
- (2) by deleting subsection (b) and deleting the designation of the remainder of the section as subsection (a).

Sec. 9. G.S. 105-164.21A is repealed.

Sec. 10. G.S. 105-116(c) is amended as follows:

- (1) by deleting the words "a public" in the third sentence of that section and substituting the words "an electric power company, a gas company, or a public"; and
- (2) by deleting the fourth sentence of that section.

Sec. 11. G.S. 105-116(g) and G.S. 105-120(d) are each amended by deleting the phrase "three and nine hundredths percent (3.09%)" and substituting the phrase "three percent (3%)".

Sec. 12. G.S. 105-120(b) is amended by deleting the phrase "three and twenty-two hundredths percent (3.22%)" and substituting the phrase "six percent (6%)".

Sec. 13. G.S. 159B-27 is amended as follows:

- (1) by deleting the phrase "three and twenty-two hundredths percent (3.22%)" each time it appears and substituting the phrase "six percent (6%)"; and
- (2) by deleting the phrase "three and nine hundredths percent (3.09%)" in subsection (d) and substituting the phrase "three percent (3%)".

Sec. 14. G.S. 105-467 is amended by deleting the last sentence of the first paragraph of that section.

Sec. 15. Section 4 of Chapter 1096 of the 1967 Session Laws is amended by deleting the last sentence of the first paragraph of that section, added by Chapter 1097 of the 1983 Session Laws (Reg. Sess. 1984).

Sec. 16. Chapter 23 of the 1985 Session Laws is repealed.

Sec. 17. This act shall become effective January 1, 1988, and shall apply to gross receipts earned from services and commodities provided on or after that date and to sales of electricity, piped natural gas, or telephone service on or after that date.

Explanation of Proposal 13

This bill converts the sales tax on electricity, piped natural gas, and telephone service to a gross receipts tax. In so doing, the bill restores the taxes on these utility services to their state before Chapter 1097 of the 1983 Session Laws (Reg. Sess. 1984) was enacted. The committee decided to recommend to reverse the changes made by that Chapter because the Tax Reform Act of 1986 eliminated the deductibility of sales tax paid by consumers in computing federal taxes and thus destroyed the rationale for the original change, which was to permit as much of the tax as possible to be deductible for federal tax purposes. The tax is easier to administer as a gross receipts tax and will stop those entities that get refunds of sales and use taxes from attempting to get refunds of tax paid on utility services.

Proposal 13

Fiscal Report
Fiscal Research Division
December 3, 1986

Summary of Proposal

This proposal converts the 3% sales tax on electricity, piped natural gas, and telephone service and the 3.22% gross receipts franchise tax on these items into a single 6% gross receipts tax. The bill thus reverses the changes made by Chapter 1097 of the 1983 Session Laws (Reg. Sess. 1984).

Effective Date

January 1, 1988

Fiscal Effect

Would increase State tax revenue approximately \$900,000 annually, primarily because of unanticipated and unintended tax benefits given municipalities that sell piped natural gas by Chapter 1097 and because eliminating the sales tax on utility services makes purchases of these services by the Department of Transportation taxable.

Legislative Proposal 14

A BILL TO BE ENTITLED

AN ACT TO EXPAND THE INCOME TAX DEDUCTION FOR EXPENSES TO
MAINTAIN A PARENT.

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-147(28) is amended by adding a new paragraph at the end of that section to read:

"An individual whose spouse is not required to file a return under this Division for the taxable year and who makes payments during that year for the maintenance and care of the spouse's parent or parents may deduct the amounts paid as if the spouse's parent or parents were his own. An individual may not deduct more than three thousand dollars (\$3,000) under this section in any year, however.

Sec. 2. This act is effective for taxable years beginning on or after January 1, 1987.

Explanation of Proposal 14

This bill expands the individual income tax deduction for expenses to maintain a parent, which became effective in tax year 1985, to permit an individual whose spouse has no income and who incurs expenses to maintain the spouse's parent to deduct the expenses for the spouse's parent as if they were expenses for his own parent. The bill preserves the \$3,000 cap on the amount of expenses to maintain a parent that may be deducted in a tax year, however. Thus, a taxpayer who incurs expenses to maintain both his parent or parents and his wife's parent or parents can deduct a maximum of \$3,000 in any year.

Proposal 14

Fiscal Report
Fiscal Research Division
December 3, 1986

Summary of Proposal

This proposal permits an individual whose spouse has no income and who makes payments to support the spouse's parent or parents to deduct the amount paid as if the spouse's parent or parents were his own. Under current law, an individual can take a deduction only for the maintenance and care of his own parent.

Effective Date

Taxable years beginning on or after January 1, 1987

Fiscal Effect

The estimate of the cost of the original \$3,000 deduction for maintaining one's own parent was \$8.0 million. Until there is data available on the usage of that deduction, it will be difficult to develop a reliable estimate of the current deduction. The cost should be at least \$2.0 million per year.

Legislative Proposal 15

A BILL TO BE ENTITLED

AN ACT TO EXPAND THE PROPERTY TAX EXEMPTION FOR GOODS STORED IN A
PUBLIC WAREHOUSE AND TO GRANT A SIMILAR EXEMPTION FOR GOODS
STORED IN A PRIVATE WAREHOUSE.

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-275(10) is amended by deleting the
first two sentences of that subdivision and substituting the
following sentence to read:

"Personal property shipped into this State and placed in a
warehouse for transshipment either inside or outside the State."

Sec. 2. G.S. 105-275(11) is amended by deleting the
first two sentences of that subdivision and substituting the
following sentence to read:

"Personal property shipped from a point inside the State and
placed in a warehouse for transshipment outside the State."

Sec. 3. This act shall become effective for taxable
years beginning on or after January 1, 1988.

Explanation of Proposal 15

This bill expands the current property tax exemption for goods stored in a public warehouse and grants the same exemption to goods stored in a private warehouse. By making these changes, the committee hopes to encourage companies to establish distribution centers in the State.

The bill expands the exemption in G.S. 105-275(10) and (11) for goods stored in a public warehouse by removing the restriction in the current law that the goods must be stored for shipment to the owner's customer as well as the restriction that the goods must be shipped out of the warehouse in the same package or form in which they entered the warehouse. Many companies that store goods in a public warehouse for shipment outside the State ship the goods to their own distribution center and not directly to their customers. This expansion exempts goods that are shipped outside the State to the owner for ultimate distribution to a customer outside the State. The expanded exemption also permits a company that places goods in a warehouse to repackage the goods before shipping the goods outside the State. For example, under the expanded exemption, a box of 12 items stored in a warehouse can be broken down and shipped out individually or in other combinations.

More importantly, the bill grants the same exemption to goods stored in a private warehouse for shipment outside the

State as is granted to goods stored in a public warehouse. For reasons of cost and control, many companies prefer to store their goods in their own warehouse.

Proposal 15

Fiscal Report
Fiscal Research Division
December 3, 1986

Summary of Proposal

This proposal expands the current property tax exemption for goods stored in a public warehouse for shipment outside the State to include goods stored for shipment to the owner of the goods as well as the owner's customers and to permit goods stored in the warehouse to be repackaged. The proposal also grants the same tax exemption for goods stored in a private warehouse for shipment outside the state as is granted to goods stored in a public warehouse.

Effective Date

Taxable years beginning on or after January 1, 1988

Fiscal Effect

The revenue loss to local governments is not determinable at this time due to a lack of data. The effect on local revenue, however, would not be significant.

LEGISLATIVE PROPOSAL 16

A BILL TO BE ENTITLED

AN ACT TO CONFORM STATE INDIVIDUAL INCOME TAX LAW ON DEPRECIATION
ALLOWANCES TO FEDERAL LAW BY PERMITTING TAXPAYERS TO EXPENSE
CERTAIN DEPRECIABLE BUSINESS ASSETS.

The General Assembly of North Carolina enacts:

Section 1. G.S. 105-147(12) is amended by rewriting
the first sentence of that subdivision to read:

"Except as provided in this subdivision, an allowance for
the following to the extent allowed under the Code:

- a. Depreciation and obsolescence of property, including an
allowance for ~~the cost of~~ property treated as an
expense under § 179 of the Code; and
- b. Depletion of mines, oil and gas wells, other natural
deposits, and timber."

Sec. 2. G.S. 105-148(2) is rewritten to read:

"(2) Amounts paid for new buildings, permanent
improvements, or betterments made to increase the value of any
property, except expenses allowed as deductions under G.S.
105-147(12)."

Sec. 3. This act is effective for taxable years
beginning on and after January 1, 1987.

Explanation of Proposal 16

This bill permits individuals to deduct the entire cost of certain depreciable business assets in the year the assets are purchased instead of depreciating the assets over several years. In so doing, the bill conforms State individual income tax law on this issue to federal. Conforming to federal law on this issue will simplify the filing of individual income tax returns by eliminating the need to keep separate depreciation records for State and federal purposes on assets that are "expensed" rather than depreciated on the federal return.

Under § 179 of the Internal Revenue Code, a taxpayer may elect to expense up to \$10,000 of each qualifying asset rather than depreciate the asset. The amount deducted under § 179 may not exceed the taxpayer's taxable income, however.

This same proposal was introduced in the 1985 Session as House Bill 1351. That proposal was introduced by Representative John Church and was not one of the recommendations of the committee.

Proposal 16

Fiscal Report
Fiscal Research Division
December 3, 1986

Summary of Proposal

Under current federal income tax law, taxpayers may elect to deduct in one year a portion of the cost of personal property that is purchased and used in a trade or business. This expensing option is in lieu of depreciating the property over a number of years. Although the limit on the expensing option was previously scheduled to increase from \$5,000 to \$7,500 in 1988 and 1989 and then from \$7,500 to \$10,000 in 1990, the Tax Reform Act of 1986 made the \$10,000 limit effective for 1987. That Act also phases out the limit on a dollar-for-dollar basis for taxpayers whose investment exceeds \$200,000 and limits the amount that may be expensed to the taxable income from the trade or business.

Effective Date

Taxable years beginning on or after January 1, 1987

Fiscal Impact

The enactment of the proposal will not have a permanent impact on State tax revenue because the full cost of personal property used in a business will eventually be recovered either through the expensing option of this proposal or depreciation. There will be a reduction, however, of at least \$2.5 million in State tax revenue on a cash flow basis beginning in 1987-88.

Legislative Proposal 17

A JOINT RESOLUTION AUTHORIZING THE LEGISLATIVE RESEARCH COMMISSION TO CONTINUE TO STUDY THE REVENUE LAWS OF NORTH CAROLINA.

Whereas, the Legislative Research Commission has been authorized by the 1977, 1979, 1981, 1983, and 1985 General Assemblies to conduct a study of the revenue laws of North Carolina; and

Whereas, since 1977 the committee appointed by the Legislative Research Commission to study the revenue laws has recommended many changes in the revenue laws in the committee's attempt to improve these laws; and

Whereas, the Revenue Laws Study Committee has proved to be an excellent forum for both taxpayers and tax administrators to present their complaints with existing law and make suggestions to improve the law;
Now, therefore, be it resolved by the House of Representatives, the Senate concurring:

Section 1. The Legislative Research Commission is authorized to study the revenue laws of North Carolina and the administration of these laws. The Commission may review the State's revenue laws to determine which laws need clarification, technical amendment, repeal, or other change to make the laws concise, intelligible, easy to administer, and equitable. When

the recommendations of the Commission, if enacted, would result in an increase or decrease in State tax revenues, the report of the Commission shall include an estimate of the amount of the increase or decrease.

Sec. 2. The Commission may call upon the Department of Revenue to cooperate with it in its study of the revenue laws. The Secretary of Revenue shall ensure that the Department's staff cooperates fully with the Commission.

Sec. 3. The Commission shall make a final report of its recommendations for improvement of the revenue laws to the 1989 General Assembly and may make an interim report to the 1987 General Assembly, Regular Session 1988.

Sec. 4. This resolution is effective upon ratification.

Explanation of Proposal 17

This joint resolution simply authorizes the Legislative Research Commission to continue to study the revenue laws of this State. The resolution gives the study of the revenue laws a broad scope and permits the Commission to make both an interim report and a final report on the results of its study of the revenue laws.

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1985

RATIFIED BILL

CHAPTER 790 SENATE BILL 636

AN ACT AUTHORIZING STUDIES BY THE LEGISLATIVE RESEARCH COMMISSION, MAKING TECHNICAL AMENDMENTS THERETO, AND TO MAKE OTHER AMENDMENTS.

The General Assembly of North Carolina enacts:

Section 1. Studies Authorized. The Legislative Research Commission may study the topics listed below. Listed with each topic is the 1985 bill or resolution that originally proposed the issue or study and the name of the sponsor. The Commission may consider the original bill or resolution in determining the nature, scope and aspects of the study. The topics are:

- (1) Continuation of the Study of Revenue Laws (H.J.R. 17-Lilley),
- (2) Continuation of the Study of Water Pollution Control (H.J.R. 141-Evans),
- (3) Adolescent Sexuality Teaching (H.J.R. 275-Jeralds),
- (4) Continuation of the Study on the Problems of the Aging (H.J.R. 322-Greenwood),
- (5) Continuation of the Study of Municipal Incorporations (H.J.R. 389-Greenwood),
- (6) School Discipline (H.J.R. 861-Colton),
- (7) Bail Bondsmen and Bail Bond Forfeiture (H.B. 967-Watkins),
- (8) Preventative Medicine (H.B. 1052-Locks),
- (9) Life Care Arrangements (H.B. 1053-Locks),
- (10) State Personnel System (H.B. 1064-Wiser),
- (11) Long-Term Health Care Insurance (H.B. 1103-Locks),
- (12) Itinerant Merchants (H.B. 1170-Lancaster),
- (13) Manufactured Housing Zoning (H.B. 1178-Ballance; S.B. 636-Plyler),
- (14) Interest Rate Regulation (H.J.R. 1227-Evans),
- (15) Underground Storage Tank Leakage Hazards and other ground water hazards (H.B. 1281-Locks),
- (16) Mental Patient Commitments (H.J.R. 1313-Miller),
- (17) High-Level Radioactive Waste Disposal (H.B. 1373-Diamond; S.B. 655-Hipps),
- (18) Stun Guns (H.J.R. 1390-McDowell),
- (19) Continuation of the Study of Water Quality in Haw River and B. Everett Jordan Reservoir (H.J.R. 1393-Hackney),
- (20) Authority of Boards of County Commissioners in Certain Counties over Commissions, Boards and Agencies (H.J.R. 1405-Holroyd),
- (21) Superintendent of Public Instruction and State Board of Education (H.J.R. 1412-Nye),
- (22) Rental Referral Agencies (H.B. 1421-Stamey),
- (23) Child Abuse Testimony Study (S.B. 165-Hipps),
- (24) Home Schooling Programs (S.J.B. 224-Winner),
- (25) Pretrial Release (S.J.B. 297-Winner),

- (26) Inmate Substance Abuse Therapy Program (S.J.B. 317-Plyler),
- (27) Inmate Work-Release Centers (S.B. 406-Swain),
- (28) Community College System (S.B. 425-Martin),
- (29) Community Service Alternative Punishment and Restitution (S.B. 495-Swain),
- (30) State Employee Salaries and Benefits (S.B. 514-Jordan),
- (31) State Infrastructure Needs (S.B. 541-Royall),
- (32) Commercial Laboratory Water Testing (S.B. 573-Taft),
- (33) Outdoor Advertising (S.B. 611-Thomas, R.P.),
- (34) Premium Tax Rate on Insurance Companies (S.B. 633-Hardison)
- (35) Continuation of the Study of Child Support (S.B. 638-Marvin),
- (36) Local Government Financing (S.B. 670-Rauch),
- (37) Medical Malpractice and Liability (S.B. 703-Taft),
- (38) Marketing of Perishable Food (S.B. 718-Basnight),
- (39) Child Protection (S.B. 802-Hipps),
- (40) Legislative Ethics and Lobbying (S.B. 829-Rauch),
- (41) Satellite Courts (S.B. 850-Barnes),
- (42) Substantive Legislation in Appropriations Bills (S.B. 851-Rand),
- (43) School Finance Act (S.B. 848-Taft).

Sec. 2. Transportation Problems at Public Facilities. The Legislative Research Commission may identify and study transportation problems at public transportation facilities in North Carolina.

Sec. 2.1. The Legislative Research Commission may study the feasibility of the prohibition of investment by the State Treasurer of stocks of the retirement systems listed in G.S. 147-69.2(b)(6), or of the assets of the trust funds of The University of North Carolina and its constituent institutions deposited with the State Treasurer pursuant to G.S. 116-36.1 and G.S. 147-69.2(19) in a financial institution that has outstanding loans to the Republic of South Africa or in stocks, securities, or other obligations of a company doing business in or with the Republic of South Africa.

Sec. 3. Reporting Dates. For each of the topics the Legislative Research Commission decides to study under this act or pursuant to G.S. 120-30.17(1), the Commission may report its findings, together with any recommended legislation, to the 1987 General Assembly, or the Commission may make an interim report to the 1986 Session and a final report to the 1987 General Assembly.

Sec. 4. Bills and Resolution References. The listing of the original bill or resolution in this act is for reference purposes only and shall not be deemed to have incorporated by reference any of the substantive provisions contained in the original bill or resolution.

Sec. 5. The last sentence of G.S. 120-19.4(b) is amended by deleting the citation "G.S. 5-4" and inserting in lieu thereof the following: "G.S. 5A-12 or G.S. 5A-21, whichever is applicable".

GENERAL ASSEMBLY OF NORTH CAROLINA
SESSION 1985

HOUSE JOINT RESOLUTION 17

Sponsors: Representatives Lilley, Locks, Mavretic, Pool; Chalk..

Referred to: Rules and Operation of the House.

February 7, 1985

1 A JOINT RESOLUTION AUTHORIZING THE LEGISLATIVE RESEARCH
2 COMMISSION TO CONTINUE TO STUDY THE REVENUE LAWS OF NORTH
3 CAROLINA.

4 Whereas, the Legislative Research Commission has been
5 authorized by the 1977, 1979, 1981, and 1983 General Assemblies
6 to conduct a study of the revenue laws of North Carolina; and

7 Whereas, since 1977 the committee appointed by the
8 Legislative Research Commission to study the revenue laws has
9 recommended many changes in the revenue laws in the committee's
10 attempt to improve these laws; and

11 Whereas, the Revenue Laws Study Committee has proved to
12 be an excellent forum for both taxpayers and tax administrators
13 to present their complaints with existing laws and make
14 suggestions to improve the laws;

15 Now, therefore, be it resolved by the House of Representatives,
16 the Senate concurring:

17 Section 1. The legislative Research Commission is
18 authorized to study the revenue laws of North Carolina and the
19 administration of these laws. The Commission may review the
20 State's revenue laws to determine which laws need clarification,

Sec. 6. G.S. 120-99 is amended by adding a new paragraph to read:

"The provisions of G.S. 120-19.1 through G.S. 120-19.8 shall apply to the proceedings of the Legislative Ethics Committee as if it were a joint committee of the General Assembly, except that the chairman shall sign all subpoenas on behalf of the Committee.

Sec. 7. G.S. 120-30.17 is amended by adding a new subsection to read:

"(9) For studies authorized to be made by the Legislative Research Commission, to request another State agency, board, commission or committee to conduct the study if the Legislative Research Commission determines that the other body is a more appropriate vehicle with which to conduct the study. If the other body agrees, and no legislation specifically provides otherwise, that body shall conduct the study as if the original authorization had assigned the study to that body and shall report to the General Assembly at the same time other studies to be conducted by the Legislative Research Commission are to be reported. The other agency shall conduct the transferred study within the funds already assigned to it."

Sec. 8. This act is effective upon ratification.

In the General Assembly read three times and ratified, this the 18th day of July, 1985.

ROBERT B. JORDAN III

Robert E. Jordan III
President of the Senate

LISTON B. RAMSEY

Liston B. Ramsey
Speaker of the House of Representatives

Appendix B

Revenue Laws Study Committee

1985 - 1986

Rep. Daniel T. Lilley
Cochairman
P. O. Box 824
Kinston, N. C. 28501

Sen. A. D. Guy
Cochairman
306 Woodland Drive
Jacksonville, N. C. 28540

Rep. Daniel T. Blue, Jr.
2451 Albemarle Avenue
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Sen. William W. Staton
636 Palmer Drive
Sanford, N. C. 27330

Rep. Harold Brubaker
Route 9, Box 268
Asheboro, N. C. 27203

Sen. R. P. Thomas
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Hendersonville, N. C. 28739

Rep. John Calvin Hasty
520 Lombard Street
Maxton, N. C. 28364

Sen. Dennis J. Winner
67 Stratford Road
Asheville, N. C. 28804

Rep. Richard Wright
Six Orange Street
Tabor City, N. C. 28463

Mr. Curtis Thompson
334 Woodland Avenue
Wake Forest, N. C. 27587

LRC member responsible for study: Senator Robert Warren

Staff: Sabra J. Faires, Legislative Services Office,
Bill Drafting Division

David Crotts, Legislative Services Office,
Fiscal Research Division

Ada B. Edwards, Committee Clerk

MAJOR FEDERAL TAX REFORM ACT CHANGES THAT
WOULD IMPACT PRIMARILY ON THE NORTH CAROLINA CORPORATE
INCOME TAX UNDER CONFORMITY LEGISLATION

Category	Explanation of Existing Federal Law		Tax Reform Bill Provision		Effective Date	
	<u>Class Life</u>	<u>Examples of Property in Class</u>	<u>Required Accounting Rule</u>	<u>Class Life</u>	<u>Examples of Property in Class</u>	<u>Required Accounting Rule</u>
Accelerated Cost Recovery System (depreciation) *	3-year	Autos, trucks	150% declining balance	3-year	Small tools used in manufacturing of certain products	200% declining balance
	5-year	Most machinery, equipment, office furniture, personal property not otherwise classified	150% declining balance	5-year	Autos, light trucks, oil & gas drilling, construction, computer equipment	200% declining balance
	10-year	Long-lived public utility property	150% declining balance	7-year	Office furniture & fixtures, other machinery & equipment	200% declining balance
	15-year	Low-income housing, longer-lived public utility property	150% declining balance (200% declining balance for low-income housing)	10-year	Specific other personal property	150% declining balance
						Property placed in service on or after January 1, 1987

<u>Category</u>	<u>Explanation of Existing Federal Law</u>	<u>Tax Reform Bill Provision</u>	<u>Effective Date</u>
	<div> <div>Class</div> <div>Life</div> </div> <div> <div>Examples of Property in Class</div> </div> <div> <div>Required Accounting Rule</div> </div>	<div> <div>Class</div> <div>Life</div> </div> <div> <div>Examples of Property in Class</div> </div> <div> <div>Required Accounting Rule</div> </div>	
	<div>19-year</div> <div>Real estate</div>	<div>15-year</div> <div>Sewage treatment plant, telephone plant, specified other personal property</div>	<div>150%</div> <div>declining balance</div>
		<div>20-year</div> <div>Specified other personal property</div>	<div>150%</div> <div>declining balance</div>
		<div>27½-years</div> <div>Residential real estate</div>	<div>Straight line</div>
		<div>31½-years</div> <div>Commercial & industrial real estate</div>	<div>Straight line</div>
Depreciation deduction on luxury autos*	<div>Year 1 - \$3,200</div> <div>Year 2 and later - 4,800</div>	<div>Year 1 - \$2,560</div> <div>Year 2 - 4,100</div> <div>Year 3 - 2,450</div> <div>Other</div> <div>Years - 1,475</div>	
Personal property expensing option limit*	<div>\$ 5,000</div> <div>7,500</div> <div>10,000</div> <div>1986; 1987</div> <div>1988; 1989</div> <div>1990 & thereafter</div>	<div>\$10,000. If investment is \$200,000 or less, limit is reduced dollar-for-dollar above \$200,000 (expensing limited to taxable income)</div>	

<u>Category</u>	<u>Explanation of Existing Federal Law</u>	<u>Tax Reform Bill Provision</u>	<u>Effective Date</u>
Extraordinary Dividends Received*	For stock held less than one year, the basis of the stock (purchase price plus commissions) must be reduced by non-taxed portion of extraordinary dividends.	Basis adjustment required if stock has not been held for more than two years prior to declaration of dividend.	Declared after July 18, 1986
Stock Redemption Payments*	Generally, expenses incurred in a corporation's purchase of its own stock are not expensed in the current year, but must be capitalized. However, in certain extraordinary cases, such expenses may be deducted in the year of the transactions.	Provides that in no case may full expenses incurred in stock redemption be deducted in one year.	Payments on or after March 1, 1986
Recognition of gain or loss in liquidations and sales of property (General Utilities doctrine)	Generally, a corporation does not recognize a gain or loss in on a distribution of its assets to shareholders in a liquidation, or in certain liquidating sale transactions following an acquisition.	Repeals General Utilities rule, so that full gain or loss is recognized to corporation on a sale or distribution of its property in complete liquidation.	Tax years beginning on or after January 1, 1987
Allocation of purchase price in certain sales of assets*	In a lump-sum sale of a going concern, the buyer and seller must each allocate the purchase price among the assets for tax purposes. (gain determination for seller, basis determination for buyer). One method of establishing goodwill and going concern value is to use the excess of the purchase price over the market value of tangible assets and identifiable intangibles (residual approach). Under formula method, goodwill and going concern value is valued based on capitalization excess earning capacity of tangible assets.	Requires uniform usage of residual method.	Transactions completed after May 6, 1986, unless pursuant to a binding contract in effect on that date.

<u>Category</u>	<u>Explanation of Existing Federal Law</u>	<u>Tax Reform Bill Provision</u>	<u>Effective Date</u>
Related Party Sales*	Installment sale treatment is not available for gains on the sale of property to a related party if the property is depreciable to transferee unless IRS approves that purpose of sale was not for purpose of tax avoidance. The related party definition uses an 80% ownership rule.	Amends ownership rule to 50%.	Sales after June 20, 1986, unless pursuant to a binding contract in effect on that date
Amortizable Bond Premium*	Whenever a taxpayer buys a bond at a premium over face value, the amount of the premiums is allowed as a deduction over the remaining term of the bond, thus offsetting interest received.	Bond premiums are treated as interest for purposes of applying limit on deduction for investment interest.	Obligations acquired on or after date of enactment
Real estate mortgage investment conduits*	No provision.	Exempts entities from corporate tax, with income passed through to interest holders. The entity is required to withhold tax on amounts paid to foreign holders and will be required to pay tax equal to 100% of income on prohibited transactions.	Tax years beginning on or after January 1, 1987

<u>Category</u>	<u>Explanation of Existing Federal Law</u>	<u>Tax Reform Bill Provision</u>	<u>Effective Date</u>
Regulated invest- ment companies*	May deduct dividends paid to shareholders during a tax year.	(1) Imposes a non-deductible 4% of excess of "required distribution" over actual distribution, unless company distributes at least 97% of ordinary income during calendar year and at least 90% of capital gains.	Tax years beginning on or after January 1, 1987
		(2) Losses on sale of invest- ment company stock held six months or less are not allowed to the extent holder received tax-exempt dividends on stock.	Tax years beginning on or after January 1, 1987
Limitation of use of cash accounting method*	Taxpayers may use cash, accrual, on any other method of accounting that clearly reflects income and is used regularly in its book- keeping.	Prohibits use of cash accounting if corporations (other than Subchapter S and personal service corporations) if taxpayer has average annual gross receipts of more than \$5 million.	Tax years beginning on or after January 1, 1987
Simplified LIFO for certain small businesses*	Businesses with average annual gross receipts of \$2 million or less can elect a single LIFO inventory pool with yearly indexes based on its own data.	Increases threshold to \$5 million and allows the use of a separate pool for each major category of inventory items (single published index of each pool)	Tax years beginning on or after January 1, 1987.

<u>Category</u>	<u>Explanation of Existing Federal Law</u>	<u>Tax Reform Bill Provision</u>	<u>Effective Date</u>
Recognition of gain on installment sales*	Gains from installment sales of property are reported based on sale schedule, unless taxpayer elects otherwise.	(1) Prohibits installment sale reporting on sale of stock or securities traded on an established securities market and property sold on a revolving credit plan. Any adjustment resulting from the change may be taken into account over a period of no more than four years.	Sales taking place on or after January 1, 1987
Capitalization of production costs*	The costs incurred in producing tangible personal property must be capitalized instead of fully deducted in year expense takes places. The rules for capitalizing the costs differ, depending on the nature of the property and its intended use.	(2) Reduces the tax benefits of installment sale treatment on sales of property by dealers and on casual sales.	Costs incurred on or after January 1, 1987
Long-term contract accounting*	Companies may account for their long-term contracts under their regular accounting method (cash or accrual), or under one of two special methods: percentage-of-completion or completed contract.	Establishes a uniform set of rules requiring the capitalization of certain previously deductible costs.	Contracts entered into after February 28, 1986
Bad debt reserve for financial institutions*	Banks and savings & loan associations may use the reserve method in accounting for bad debts, (based on experience) or "percentage of eligible loans", as an alternative to a specific change-off.	Prohibits banks with assets of more than \$500 million from using the reserve method and limits the bad debt write-off for savings and loan associations.	Tax years beginning on or after January 1, 1987

Category	Explanation of Existing Federal Law	Tax Reform Bill Provision	Effective Date
Bad debt reserve for non-financial institutions*	Taxpayers may take a deduction for losses on business debts based either on the specific charge-off method (write-off when debt is wholly or partially worthless) or reserve method.	Prohibits reserve method and substitutes a different experience-based system.	Tax years beginning on or after January 1, 1987
Qualified discount coupons*	Issuers of qualified discount coupons using the accrual method of accounting may elect to deduct the cost of redeeming coupons outstanding at the close of the taxable year and coupons received for redemption by the taxpayer within a statutory redemption period following the close of the taxable year.	Allows a deduction only for those costs of redeeming discount coupons received for redemption during the taxable year. Net adjustment may be taken over four-year period.	Tax years beginning on or after January 1, 1987
Public utility income recognition rules*	Public utilities using the accrual method of accounting may recognize income in the taxable year in which the customer's meter is read, or the year in which the <u>utility</u> actually bills the customer.	Requires accrual method utilities to report income from the sale of utility services in the year in which the services are <u>provided</u> to the customer.	Tax years beginning on or after January 1, 1987
Contributions in aid of construction	Public utilities may treat contributions in aid of construction as a contribution to capital not includible in gross income.	Repeals exclusion.	Contributions received beginning January 1, 1987
Indebtedness discharge exclusion*	Solvent taxpayers may exclude from income the discharge of a debt by reducing the basis of depreciable property.	Repeals exclusion unless the discharge occurs in a Title 11 bankruptcy case or taxpayer is insolvent.	Debt cancellations occurring on or after January 1, 1987

<u>Category</u>	<u>Explanation of Existing Federal Law</u>	<u>Tax Reform Bill Provision</u>	<u>Effective Date</u>
Private-activity bond interest exclusion	If more than 25% of proceeds of bond are used in a trade or business, or more than 5% of proceeds are used to make loans to private entities, interest income is taxable with certain exceptions.	Lowers threshold to 10% and declares that a bond is private-activity if the lesser of 5% or \$5 million of proceeds from issue are used for loan to private entity.	Bonds issued on or after September 1, 1986

*Change will not affect overall tax liability, but could affect timing of tax payments.

MAJOR FEDERAL TAX REFORM ACT CHANGES THAT
WOULD IMPACT PRIMARILY ON THE NORTH CAROLINA
INDIVIDUAL INCOME TAX UNDER CONFORMITY LEGISLATION

<u>Category</u>	<u>Explanation of Current Federal Law</u>	<u>Federal Tax Reform</u>	<u>Effective Date</u>
Individual Retirement Accounts	Allows self-employed persons and persons covered by an employer-sponsored retirement plan to deduct up to \$2,000 per year for self and up to \$250 for non-working spouse for contribution to an individual retirement account. Taxes are paid on the withdrawal of the proceeds from the plan.	The deduction for taxpayers covered by an employer-sponsored retirement plan is phased out between \$25,000 and \$35,000 (\$40,000 - 50,000 for joint return). The spousal deduction is available if one spouse earns \$250 or less and the other spouse meets the income requirements. Interest earnings on nondeductible contributions will remain exempt. Withdrawal of nondeductible contributions will be exempt.	Contributions and distributions in taxable years beginning on or after January 1, 1987.
Qualified cash or deferred arrangements (401(k), 403(b), 457 plans)	Excludes from income up to \$30,000 (or 25% of salary whichever is less) of employer contributions plus employee salary deferrals to a tax-qualified profit-sharing or stock bonus plan.	Limits exclusion to \$7,000 per year of employee deferrals (limit on combined employee deferrals and employer contribution remains at 25% of income, or \$30,000, whichever is less).	Tax years beginning on or after January 1, 1987.
Distribution from qualified plans	For lump-sum distribution option, allows ten-year averaging method. Under annuity distribution option, if total payments received within first three years exceed nondeductible contributions, no tax is due on proceeds until they exceed contributions.	For lump-sum distribution allows five-year averaging method. Eliminates three-year rule under annuity distribution option.	Tax years beginning on or after January 1, 1987

<u>Category</u>	<u>Explanation of Current Federal Law</u>	<u>Federal Tax Reform</u>	<u>Effective Date</u>
Excise tax on early withdrawals from qualified plan	A 10% additional income tax applies to early withdrawals from an IRA, except in cases of death or disability.	Extends penalty to any qualified, retirement plan, excluding plans for state and local employees (Sec. 457). Exceptions include death, disability, or cases where a series of substantially equal periodic payments are made.	Withdrawals effective for tax years beginning on January 1, 1987.
Simplified employee pensions (SEP's)	If an IRA qualifies as a simplified employee pension, the annual IRA deduction limit is increased to the lesser of \$30,000 or 15% of compensation. The limit applies only to employer contributions on behalf of an employee.	Certain employees who participate in a SEP will be allowed to have contributions made to the SEP or to receive contributions in cash. If the employee chooses the contribution option, the contribution is not treated as having been distributed or made available to the employee. Elective deferrals are subject to the same limit as 401(k) plans. The election applies only to employers with 25 or less employees and where at least 50% of employees make election.	For years beginning on or after January 1, 1987.
Scholarship & fellowship exclusion	Excludes from gross income amounts received as a scholarship or as a fellowship grant from a higher education institution, as well as incidental amounts received and spent for travel, research, clerical help, or equipment.	Limits exclusion to individuals who are degree candidates and to that part of scholarship or fellowship required to be used and actually expended for tuition, course fees, books, supplies, and equipment.	Scholarships & fellowships granted after September 25 1985.

Category	Explanation of Current Federal Law	Federal Tax Reform	Effective Date
Soil & water conservation expenses	Taxpayer may deduct instead of capitalizing certain costs incurred with soil and water conservation. The annual deduction is limited to 25% of the taxpayer's gross income from farming.	Limits expensing option to expenditures consistent with plan of state or federal soil conservation agency, and excludes a couple types of expenditures from election.	Expenditures made on or after January 1, 1987.
Employer-provided dependent care expense	Excludes from income amounts paid or incurred by an employer for dependent care assistance provided to an employee through a dependent care assistance program. The exclusion is limited to gross income.	Limits exclusion to \$5,000.	Tax years beginning on or after January 1, 1987.
Foreign income exclusion	Allows exclusion of up to \$80,000 of foreign earned income (phased up \$5,000 per year to 1990).	Reduces exclusion to \$70,000.	Tax years beginning on or after January 1, 1987.
Moving expenses	Allowed as an adjustment in determining adjusted gross income.	Becomes an itemized deduction (not subject to new 2% limit on miscellaneous itemized deductions).	Tax years beginning on or after January 1, 1987.
Tax shelter at-risk rules	Allows an at-risk limitation on losses from income-producing activities other than real estate and certain corporate active business activities.	Applies at-risk rules to real estate activity.	Property placed in service on or after January 1, 1987.

APPENDIX D

Speakers At Committee Meetings

<u>Speaker</u>	<u>Subject of Presentation</u>
Ken Banks N.C. Association of Certified Public Accountants	Tax Reform Act of 1986
Michael Crowell Tharrington, Smith & Hargrove	Sales tax on advertising
David Crump Attorney General's Office	Bingo licensing
Fred Edgecombe National Rifle Association	Gun dealer privilege license
Edwin Edgerton Solicitation Licensing Branch Chief Department of Human Resources	Charitable solicitation licensing
James Hanford CSX Transportation, Inc.	Sales tax on diesel fund
Eric Johnson Gun Dealer in Charlotte	Gun dealer privilege license
Jack Little Whetstone Army Navy	Gun dealer privilege license
Rick Manning National Rifle Association	Gun dealer privilege license
John Rigsbee N.C. Association of Certified Public Accountants	Tax Reform Act of 1986
Justine Rozier N.C. Association of Retired Federal Employees	Income tax exemption for pensions of retired federal employees
Bud Skinner Department of Commerce	Inventory tax
Art Sperry Sperry & Associates	Sales tax on advertising
Tom Stapleton Director of Economic Development Greensboro Chamber of Commerce	Inventory tax

W.B. Wilkinson
BASF Corporation

Property tax on goods in
private warehouse

Orville Wright
Black & Decker, Inc.

Property tax on goods in
private warehouse



HECKMAN
BINDERY INC.



MAR 87
N. MANCHESTER,

